NATIONAL FORECAST DESCRIPTION

The Forecast Period is the Third Quarter of 2002 through the Fourth Quarter of 2006

Federal Reserve Chairman Alan Greenspan recently described the U.S. economy was in a "soft spot." This implies that the economy is fundamentally sound, but is not performing to satisfaction. Namely, real output seems to be moving along, but the lack of job growth is frustrating. Real GDP advanced at a 4.0% annual rate in the third quarter of 2002—its fourth uninterrupted quarter of growth. In contrast, the nation's nonfarm payroll has decreased during this same period. In November 2002, the U.S. civilian unemployment rate stood at 6.0%--four-tenths of a percentage point higher than in November 2001. Unfortunately, the unemployment rate will likely rise further. This is the classic relationship between output and employment. Employment lags output because businesses are hesitant to add to payrolls until they are sure the economy on solid footing. In order for the unemployment rate to start falling, businesses need to add about 100,000 jobs a month.

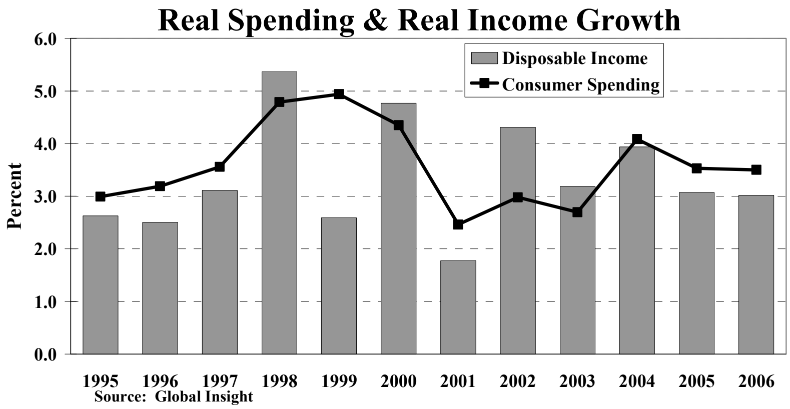
This begs the question: When will companies begin hiring? After all, the recession probably ended almost a year ago. (At the time of this writing the National Board of Economic Research had not officially declared the recession ended.) As was mentioned above, hiring will resume en force when companies are convinced of the recovery. This should take place in the second half of this year. Nonfarm employment is forecast to grow over one percent in the third quarter of this year for the first time since the second quarter of 2000. This should nudge the U.S. civilian unemployment rate down slightly. In the third quarter of 2003, hiring should accelerate to above 3.0% and the unemployment should drop further. After that, the unemployment rate should fall steadily to its full-employment threshold.

A key feature of the current U.S. economic forecast is the assumption that Congress will pass the President's tax relief package in early 2003. Global Insight assumes the package is worth $45 billion in its first year, comprised of a mix of cuts in personal income taxes. Elimination of the personal tax on dividends could well account for half, with acceleration of some already-scheduled changes accounting for the rest. With this added stimulus, real GDP is expected to increase 2.9% this year and 4.5% next year. Both estimates are about three-tenths of a percentage point higher than in the previous forecast. The stimulus wears off over the length of the forecast period, however.

It is also assumed in this forecast the Federal Reserve will not loosen further. After displaying unusual generosity in November 2002 by cutting its federal funds rate by one-half percentage point, the nation's central bank passed on a chance to loosen further during its December 2002 meeting. It is taking a wait-and–see position to determine if the economy gets through this soft patch without further interest rate tax cuts. Another reason the Federal Reserve is being cautious is because with rates already so low, it is running out of options. The rate cannot be lowered below 0.0%. This forecast assumes the economy, with the help of an accommodative fiscal policy, should pick up speed in the second half of this year. Therefore, further cuts by the nation's central bank will be unnecessary in the near future.

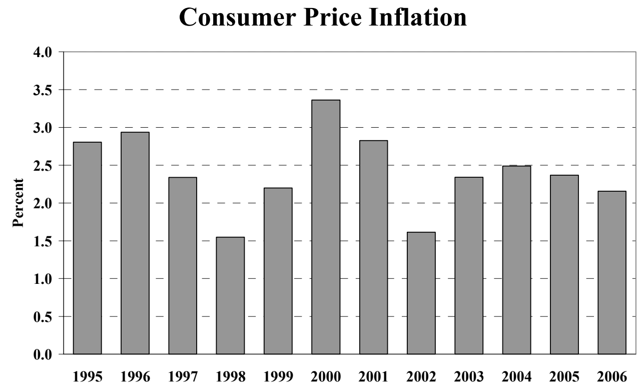
Nationally, real GDP is projected to increase 2.9% in 2003, 4.5% in 2004, 3.7% in 2005, and 3.4% in 2006. And employment will begin growing once again. Specifically, nonfarm employment is forecast to grow 0.8% this year, 2.5% next year, 1.9% in 2005, and 1.2% in 2006. This will be a welcome relief compared to the job-growth drought of 2001-2002.

SELECTED NATIONAL ECONOMIC INDICATORS



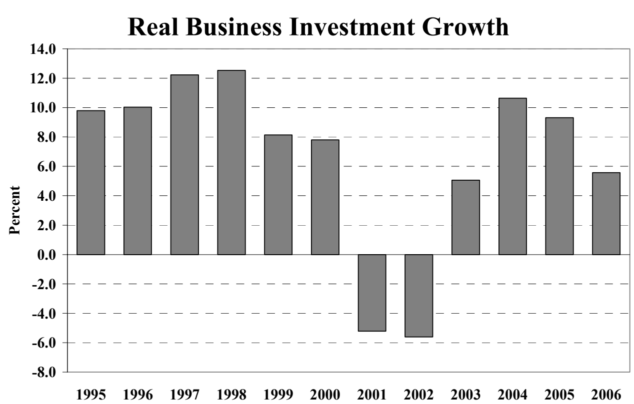
Consumer Spending: American consumers have been the economy's heroes during the recent slowdown. Thanks to their resilience and continuous spending, the recession should be one of the mildest on record. Their performance also marks a historical departure. Traditionally, it is weak consumer spending that leads to a recession. One need only look back to the early 1990s for a classic example. The U.S. suffered a recession in 1990-91. Real GDP declined nearly 1.5% over the three quarters of decline. Interestingly, real consumer spending dropped for just two quarters, but the total decline was almost as great (1.3%) as the decline in total output. A look at how this drop was distributed among its major components reveals a pattern that is close to the historical norm. Real spending on durable goods was hardest hit. It went into reverse for a whole year and declined 10.8% from its peak to trough. This is typical behavior because consumers can postpone purchasing big-ticket items, such as automobiles and major appliances, until their finances improve. Consumers have less leeway with nondurable items or services. For example, one can put off a trip to the grocery store or the dentist for only so long. These two sectors are also much larger than the durable goods sector, so they are weighted more heavily in aggregate spending. During the last recession, real nondurable spending fell just 1.4% and services spending declined just 0.25%. The 2001 recession also lasted three quarters, and that is the most it had in common with the 1990-91 recession. Real output dropped just 0.6% in the 2001 recession, versus 1.5% in the previous downturn. A major reason for this difference is real consumer spending did not decline during the most recent recession. From the last quarter of 2000 to the third quarter of 2001, real consumer spending actually increased 1.3%. The usual dip in durable goods spending never occurred. Instead, it increased 5.3%. And it has continued to increase. Part of the continued durable spending growth reflects the healthy housing market. Soon after a home is purchased, most new owners shop for items to personalize their new abode. In addition, the lowest mortgage interest rates in a generation have led to a refinancing stampede. This is also a boon to spending because consumers "cashing out" a part of the new loan or lower monthly payments of new loans provide incentive to spend. But even the record low mortgage rates pale in comparison to interest rates available to automobile purchasers. Zero-percent financing caused vehicle purchases to soar. While these factors helped make the most recent slowdown mild, they will also make the recovery mild. Usually, the bigger the decline in spending during a recession, the bigger the surge in spending during a recovery. This is because demand is pent up during the recession. In the most current recession, consumer spending never fell off, so there is little, if any, pent up demand to be met. Therefore, no surge in consumer spending is expected. Instead, spending should grow roughly in line with real disposable personal income. Specifically, real consumer spending is forecast to advance an average of 3.4% per year through 2006. However, it should be pointed out there will be two distinct growth periods. In the first two years growth is expected to remain under three percent, while it is above three percent in the last three years.

Inflation: The latest price data suggest the U.S. is near a point of price stability. Not since the early 1960s have the top-line measures of inflation been so low. The broadest measure of inflation available--the implicit price deflator for gross domestic product—increased 0.8% for the year ended with the third quarter of 2002, its lowest rate of change since 1961. For the 12 months ending in September 2002, the consumer price index (CPI) was up a mere 1.5%. Goods price inflation, as measured by producer price index for finished goods (PPI), actually fell in the past year. Both the CPI and PPI have occasionally dipped this low in the last four decades, most recently in 1986 when oil prices collapsed. What is different now is labor cost acceleration is also slowing. The employment cost index for private industry workers (ECI) rose 0.6% in the third quarter of 2003, about half the 1.1% rate of the previous quarter. Interestingly, the wages component of ECI was up just 0.4%, the smallest gain since the ECI began tracking wage growth in 1980. Over the last four quarters, compensation costs in the private sector have risen 3.7%, their slowest rate since late 1999. This forecast anticipates inflation bottoming out in late this year. It is unlikely to show much acceleration during 2003, however, and certainly not in the first part of the year. There are three reasons for this: ample capacity, sluggish job growth, and falling energy prices. Domestically, capacity utilization rates are near 74%, which is well below the 82% considered full capacity. The current forecast projects capacity utilization will improve slowly. Utilization rates should remain below 80% through 2005. Labor markets are also not expected to improve rapidly over the next couple of years, which will inhibit wage growth. Indeed, total compensation costs are forecasted to move up less than 3.5% in 2003 and 2004—a lower rate than in 2002. Lower oil prices are the third major factor limiting inflation. The $3-$5 war premium is already eroding, and fundamentals continue pointing to a price range of $21-$23 per barrel of oil over the near term. However, supply disruptions of Venezuelan oil could put upward pressure on crude oil prices. The CPI is expected to rise just 2.3% in 2003, 2.5% in 2004, 2.4% in 2005, and 2.2% in 2006.



Source: Global Insight

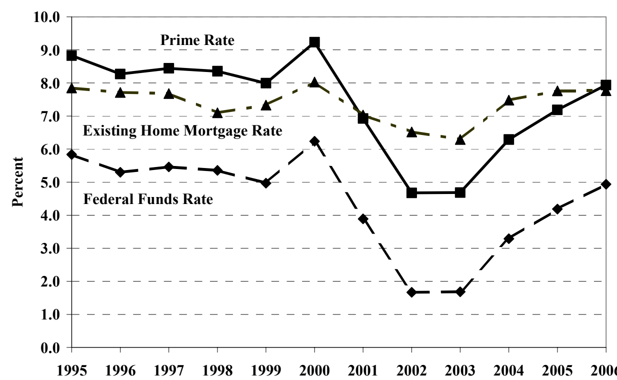
Business Investment: The collapse in real business investment is one of the main reasons for the 2001 recession and its sluggish growth has hampered the economic recovery. This sector was not always scorned. In fact, it was the darling of the economy through most of the 1990s. Fueled by the Internet gold rush, The Telecommunications Act of 1996, and Y2K fears, real business investment grew faster than real GDP in every year from 1992 to 2000. In three of those years it grew at double-digit rates. This string of growth years came to a halt in 2001, when real business investment actually declined 5.2%--its biggest drop since 1991. Unfortunately, the next year was slightly worse. It has been estimated real business investment declined another 5.6% in 2002. This decline has been frustrating because it took place at a time when the cost of borrowing was especially favorable. A couple of factors help explain why businesses have been hesitant to invest. First, given the current excess capacities in many industries, it makes no economic sense to invest in additional capacity. Second, the soft stock market restricts companies' ability to raise equity capital. Third, weak earnings also limit funding for business investment. Obviously, real business investment will not remain in reverse forever. Replacement



Source: Global Insight

demand will fuel some growth and higher future earnings will boost investment. However, a return to the salad days of the late 1990s is not expected. Much of the strength during those years reflects excess investment that has resulted in today's surplus capacities. This is not a mistake companies are likely to soon repeat. It should be pointed out that some sectors are already showing signs of life. Spending on communications equipment grew through most of 2002, indicating several lines of business are doing fine, despite the implosion of the communication sectors. This reflects the strong demand for DSL and cable TV Internet connections. However, communications equipment spending should drop in the long run as a result of further consolidation in the industry. Real business investment is forecast to advance 5.1% in 2003, 10.6% in 2004, 9.3% in 2005, and 5.6% in 2006

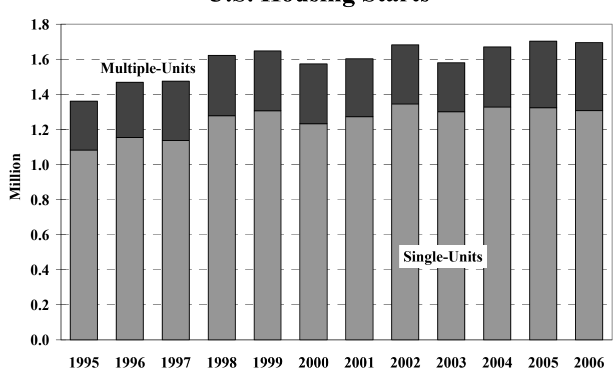
Selected Interest Rates



Source: Global Insight

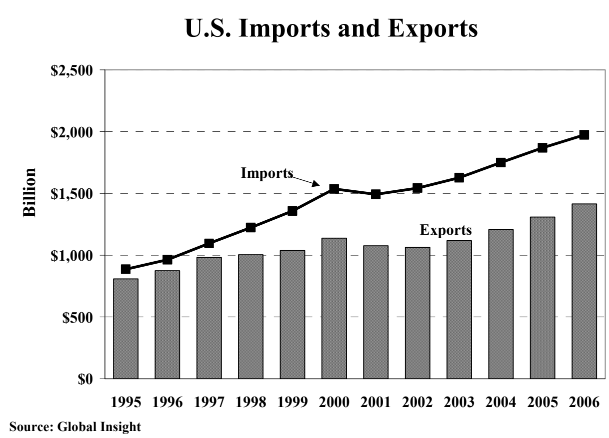
Financial: The nation's central bank is in uncharted waters. The Federal Reserve usually has the difficult task of balancing its goal of keeping prices stable without hurting the economy. It has proven to be very adept at balancing on this razor's edge. Chairman Greenspan and company have already successfully pulled off one of the most difficult policy moves in the recent past: a soft landing. Before the 2001 recession, the central bank was able to lower inflation without causing a downturn. However, current conditions have changed. First, inflation is tame. Second, instead of trying to cool an overheating economy the Federal Reserve must now jump-start the economy. The lack of inflation is welcome because it provides greater latitude for policy making. However, the current federal fund interest rate of 1.25% is limiting policy choices. The Federal Reserve has used interest rate targets as its tool of choice for meeting policy goals. However, with the federal fund rate so close to zero, it is finding its options limited. Ironically, after straddling the razor's edge so successfully, the central bank is running out razor. Because of the 6 to 12-month lag between an interest rate change and its impact on the economy, the results of this change remain to be seen. Two questions remain: What will be the Federal Reserve's next move and when will it take place? Policy makers passed on their latest opportunity to change rates during its December 10, 2002 meeting. This forecast assumes the Federal Reserve will leave rates unchanged until it is sure the economy is on solid ground, which is the second half of this year. At that time, it will begin to raise its bellwether federal funds rate. The federal funds rate is projected to average 1.68% in 2003, 3.29% in 2004, 4.19% in 2005, and 4.94% in 2006.

U.S. Housing Starts



Source: Global Insight

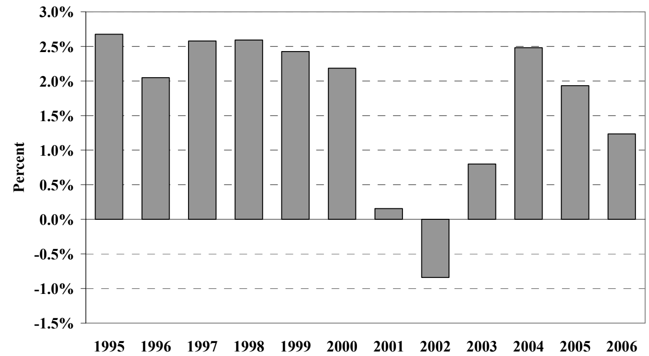
Housing: The U.S. housing market is expected to pause in 2003 after experiencing remarkable growth in recent years. However, it is forecast to resume its upward trend after 2003. Like consumer spending, housing starts have been one of the few areas of growth during the recession. But to limit a review of housing to the period during and after the recession would short change its success because housing began growing well before that time. In fact, it started nearly a decade earlier at the end of the previous recession. Despite nearly constant warnings housing starts had already peaked, U.S. housing starts grew an average of 6.3% annually from 1991 to 1999, from just over 1 million units to almost 1.65 million units. The latter was its strongest showing since 1986. Housing starts slipped slightly in 2000, but advanced in both 2001 and 2002. There are several factors that contributed to the housing industry's success in those two years. The most obvious factor is falling mortgage interest rates. Thanks to the lowest rates in a generation, mortgage debt service's portion of disposable income has shrunken, and that has increased the affordability of home ownership. Of course, even these low interest rates would not spur growth if consumers were worried about the future. Thankfully, consumer confidence has proven resilient to the recession and the slow recovery. While confidence has declined slightly, it remains higher than during the 1990-91 recession. The housing industry has also been the beneficiary of the stock market implosion. With financial markets in retreat, real estate has proven to be a solid investment. The flurry of housing activity has made predicting its future murky. For example, the steady decline in mortgage rates may have sped up so much home buying that activity could drop sharply when rates turn up. This could happen in 2003, as the mortgage interest rates begin rising in the second half of that year. Not surprisingly, U.S. housing starts are expected to decline by about 100,000 units from 2002. Mortgage rates are anticipated to continue rising through 2006, but housing starts are projected to recover beginning in 2004. A major reason for this is nonfarm employment, which had been languishing since 2001, should advance at healthy rates. This will lift consumers' confidence. In addition, any increase in debt service due to higher interest rates is expected to be offset by growing disposable personal income. National housing starts are projected to be 1.68 million units in 2002, 1.58 million units in 2003, 1.67 million units in 2004, 1.70 million units in 2005, and 1.69 million units in 2006.



International: The global economy's mediocre recovery is running out of steam and is in need of a strong dose of policy stimulus. November 2002's 50-basis-point rate cut by the Federal Reserve was a good start. The European Central Bank's cut in its key overnight rate from 3.25% to 2.75% was a good follow up, but more is needed if the world economy is to do better than just muddle along. This will not happen until some of world's largest economies make some fundamental changes. Currently, it seems most of the world are placing bets that the U.S. economy will be able to pull them out of their dire straights. Unfortunately, the U.S. economy does not have the horsepower to carry the entire global economy, and other developed economies must do their shares. But many of these countries, such as Japan and Germany, are suffering from structural problems and they are not willing to take the steps necessary to resolve them. Japan is pursuing a weak yen policy in an attempt to export itself back to prosperity. This is the latest in a series of policies to kick-start Japan's stalled economy. It used fiscal and monetary policy to temporarily lift its economy, but long-term success remained elusive. Given current circumstances, the weak yen policy also seems doomed. This is because the yen is already weak. It has depreciated 15% over the past two years, during which time producer prices have fallen more than 5% and the equities market has declined 40%. The bottom line is Japanese assets and goods are already bargain-priced to foreign buyers. Japan will be stuck with economic malaise until it takes the bitter pill of structural reform. Germany is not in a position to pursue a weak euro policy, but is still looking for at least a temporary boost. But Germany has other problems. Once the world's epitome and chief proponent of fiscal restraint, it has been warned by the European Union about the size of its budget deficit. Recently, Germany has pushed back its goal of eliminating its deficit by 2004. Instead, it will attempt to do achieve a balanced budget by 2006. Meanwhile, Germany is at risk of exceeding the 3% of GDP ceiling allowed for its budget deficit. Germany has also been called on to reduce its persistently high unemployment rate and regional disparities in its unemployment rates. To do this, Germany must reform its current benefit system to make it more worthwhile for the unemployed to take work, to tackle the other incentives to labor market inactivity, and to deregulate its product and labor markets.

Employment: A full year after real output has resumed growing, nonfarm employment remains in the doldrums. Those hoping for a quick resolution to this problem will be disappointed. The latest blow came in the form of the November 2002 employment numbers. According to the U.S. Department of Labor, the U.S. unemployment rate jumped three-tenths of a percentage point to 6.0% from October 2002 to November 2002. Other evidence of the weak employment situation was the nearly 40,000 decline in nonfarm jobs during this same period. This drop came to a surprise to many economists who were expecting a small increase in the number of jobs. Not all the news was bad. The number of initial claims for jobless benefits declined by 13,000 in November 2002. Unfortunately, it appears the employment situation will worsen before it improves. While frustrating, the softness in employment is typical after a recession. Until businesses are certain demand for their products are solid, they will be hesitant to expand their payrolls. Instead, they will use other measures, such as increased overtime, to meet rising demand in the short run. It is only after all these measures have been tapped that employment will grow. It has been estimated the economy must provide around 100,000 jobs per month in order for the nation's unemployment rate to fall. Unfortunately, this is not expected until late 2003. Specifically, the first time nonfarm employment growth is expected to reach the 100,000 threshold is in the last quarter of 2003. As a result, the U.S. civilian unemployment rate is projected to remain near 6.0% until that time. Nonfarm employment is forecast to increase 0.8% in 2003, 2.5% in 2004, 1.9% in 2005, and 1.2% in 2006. This should cause the nation to move closer to full employment over the next few years. Most of the new jobs created will be in the services-producing sector. In fact the goods-producing sector is not expected to post an employment increase until 2004. If this forecast holds true, this sector would have experienced job losses before the overall economy and be the last sector to enjoy increases during the recovery. This sector's sluggishness is largely attributed to its manufacturing component. A look at historical employment numbers shows how hard manufacturing has been hit. Manufacturing began shedding jobs in the third quarter of 2000, about a year before the economy slipped into a recession. This situation is not expected to improve until the end of this year. From its peak to trough, manufacturing is estimate to have lost 2.5 million jobs, or 13.3% of its employment base. Unfortunately, this cumulative job loss is not expected to be made up over the forecast period.

U.S. Nonfarm Employment Growth



Source: Global Insight